Validity of State Statute Basing Tax on Authorized Capital Stock of a Foreign Corporation

From the rule of *Bank of Augusta* v. *Earle*, 13 Pet. 519, 10 L. Ed. 274 (1839), that a foreign corporation has no absolute right of recognition beyond the jurisdiction of its creator, existing in other states only by their consent, Mr. Justice Field, in the celebrated decision of *Paul* v. *Virginia*, 8 Wall. 168, 181, 19 L. Ed. 357 (1869), deduced, "as a matter of course, that such assent may be granted upon such terms and conditions as those States may think proper to impose. They may exclude the corporation entirely; they may restrict its business to particular localities; or they may exact such security for the performance of its contracts with their citizens as in their judgment will best promote the public interest." On the meagre concept of comity, corporations were able to continue in the conduct of local business, but this did not impair or deny the state's arbitrary power. *Runyan* v. *Coster*, 14 Pet. 122, 10 L. Ed. 382 (1840); *Hooper* v. *California*, 155 U. S. 648, 15 Sup. Ct. 207 (1895); *Hemphill* v. *Orloff*, 277 U. S. 537, 548, 48 Sup. Ct. 577, 579, 72 L. Ed. 978 (1928); *Doyle* v. *Continental Insur. Co.*, 94 U. S. 535, 24 L. Ed. 148 (1876); *Security Mutual Life Ins. Co.*, v. *Prewitt*, 202 U. S. 246, 26 Sup. Ct. 619, 50 L. Ed. 1013 (1906). Such a restrictive judicial attitude reflected, however, what was at that time "the social resultant of the local jealousies and provincial interests of the more agrarian communities, and the budding nationalism of commerce and finance." See Henderson, "The Position of Foreign Corporations in American Constitutional Law," pages 163-164 (1918).

But the dynamic economic changes that followed 1869, making nationwide enterprise the rule rather than the exception, had by 1910 persuaded a majority of the United States Supreme Court that the doctrine of *Paul* v. *Virginia* was no longer socially or economically justifiable. W.B.R., *The Adoption of the Liberal Theory of Foreign Corporations*, 79 U. of Pa. L. Rev. 956, 962 (1930-1931); Henderson, *supra*, 163-164; Thomas Reed Powell, "Indirect Encroachment of Federal Authority," 31 Har. L. Rev. 572, 584-618 (1917-1918). The reversal in attitude is revealed in *Western Union Telegraph Co.* v. *Kansas*, 216 U. S. 1, 30 Sup. Ct. 190, 54 L. Ed. 355 (1910), holding invalid a Kansas statute requiring of every foreign corporation as a condition of its right to continue in or to commence local business the payment of an entrance fee based upon and graduated according to total authorized capital stock. Mr. Justice Harlan, delivering the opinion of the Court, ascribed invalidity to two features of the act: (1) it taxed

property of the Company located outside of the state in violation of the due process clause; and (2) the intrastate and interstate business of the Company being economically inseparable, the tax on the capital stock, which represented the property and business, constituted an unreasonable burdening of interstate commerce. The Justice recognized the force of *Paul* v. *Virginia* but distinguished it on the fact that the corporation there involved was an ordinary business concern not engaged in interstate commerce. *Western Union* case, *supra*, p. 33; Thomas Reed Powell, *supra*, p. 609.

Mr. Justice White, concurring with the majority, rested his view upon a doctrine of estoppel grounded in due process. Kansas had by tacit consent permitted Western Union to do intrastate business there along with its interstate activities, as a result of which the two phases had become inextricably interconnected. Consequently, reasoned the Justice, the alternative of eviction or submission to the fee amounted to confiscation of corporate property, although clearly no such conclusion would follow where the corporation had never entered the state to do intrastate business. *Paul* v. *Virginia*, however, was not without its champions. Mr. Justice Holmes, dissenting for himself and two brethren, confessed his "inability to understand how a condition can be unconstitutional when attached to a matter over which a State has absolute, arbitrary power." *Western Union* case, *supra*, p. 54. He neatly cuts the heart out of Justice White's estoppel theory by citing many cases to the effect that generally a corporation already in the state is infected with the original weakneess of dependence on the will of the state. *Western Union* case, *supra*, p. 54. But in 1912, these champions of the doctrine of restrictive state power conceded the victory to the rule of the *Western Union* case as applied to corporations engaged in public utility activities. *Atchison, T. & S. F. R. Co.* v. *O'Connor*, 223 U. S. 280, 32 Sup. Ct. 216 (1912).

The corrosion of the restrictive theory of *Paul* v. *Virginia* was temporarily halted at this point when in 1913 a divided Supreme Court in *Baltic Mining Co.* v. *Massachusetts*, 231 U. S. 68, 34 Sup. Ct. 15, 58 L. Ed. 127 (1913), sustained a Massachusetts statute imposing on every foreign corporation an annual excise tax to be assessed on one-fiftieth of one per cent of the par value of its authorized capital stock; but the amount of such tax in no case to exceed $2000. The two corporations involved in the case operated ordinary non-utility businesses; there did not exist, therefore, that almost complete economic fusion of interstate and intrastate business peculiar to the utility. Sustaining the measure of the tax, the Court held that: (1) the tax was an excise upon the privilege

of carrying on business within the state and not a tax on the extraterritorial property of the corporations violative of due process; and (2) the $2000 maximum limit of taxation constituted a reasonable charge for the privilege granted with no unreasonable burden resulting to interstate commerce.

After this lull in the onrush of the new doctrine, the judicial axe again fell in *Looney* v. *Crane Co.*, 245 U. S. 178, 38 Sup. Ct. 85, 62 L. Ed. 230 (1917), this time terminating the life of a statute requiring payments by foreign corporations of a permit and a franchise tax, both without maximum limits. The fact that the complaining taxpayer was not of the public utility class did not save the statute; the rule of the *Western Union* case was extended to manufacturing and commercial corporations, at least in the absence of a safeguarding maximum limitation. This qualification loomed for a time as quite significant; indeed, the cases appeared to teach that validity turned on the presence of a maximum provision. Thus it was this distinction between the statutes in the two cases which the Court had in mind in distinguishing the *Baltic Mining* decision on the ground that the peculiar provisions of the Massachusetts statute were compatible with the Constitution. *Looney* case, *supra*, at p. 190. On the other hand, omission several years later of maximum provisions in this same Massachusetts statute resulted in a holding of invalidity in *International Paper Co.* v. *Massachusetts*, 246 U.S. 135, 38 Sup. Ct. 292, 62 L. Ed. 624 (1918). In accord, *Alpha Portland Cement Co.* v. *Massachusetts*, 268 U.S. 203, 45 Sup. Ct. 477, 69 L. Ed. 916 (1925); *Locomobile Corp. of America* v. *Massachusetts*, 246 U.S. 146, 38 Sup. Ct. 298, 62 L. Ed. 631 (1918). See Colbert and Pyke, *Taxation of Foreign Corporations*, 5 Cin. L. Rev. 54 (1931). Further proof seemed to lie in the favorable treatment twice accorded the Virginia statute (Tax Code Va. Sec. 207, Code 1936, p. 2463) which exacted a fee for local business based on total authorized capital stock, but with maximum limits. In *General Railway Signal Corp.* v. *Virginia*, 246 U.S. 500, 38 Sup. Ct. 360, 62 L. Ed. 854 (1918), the Court emphasized the presence of maximum limits, though emphasis was likewise placed upon the fact that for each bracket there was laid a flat fee not varying in direct proportion to the measure utilized. In *Western Union Gas Construction Co.* v. *Virginia*, 276 U.S. 597, 48 Sup. Ct. 319, 72 L. Ed. 723 (1928), the Court was content to sustain the statute in a per curiam opinion.

Despite these indications, the era of the maximum limitation as a validating provision came to an abrupt end shortly thereafter in *Cudahy Packing Co.* v. *Hinkle*, 278 U.S. 460, 49 Sup. Ct. 204, 73 L. Ed. 454

(1929). Though the maximum was but $3000 the Court would have none of it. This immunization gone, utility and non-utility foreign corporations were alike within the protective mantle of the *Western Union rule*. The unqualified triumph of the new doctrine is brought home in the Court's outright repudiation of the *Baltic Mining* case. Not without great significance is the fact that the doctrine of *Paul* v. *Virginia* found in the *Cudahy* case another great champion in Mr. Justice Brandeis. In dissenting in the *Cudahy* case, *supra*, pages 467-68, he declared: "The taxes are not measured by the amount of interstate commerce. They do not grow, or shrink, according to the volume of interstate commerce or of the capital used in it. They are not furtively directed against such commerce. The taxes would be precisely the same in amount if the corporation did in Washington no interstate business whatsoever. Nor are the taxes laid upon property without the State. Indeed, they are neither property taxes nor substitutes for property taxes. They are an excise, laid solely for the privilege of doing business as a corporation."

The sympathetic attitude which Mr. Justice Brandeis there manifested toward the doctrine of *Paul* v. *Virginia* again reveals itself in the very recent case of *Atlantic Refining Co.* v. *Commonwealth of Virginia*, 301 U.S.—, 58 Sup. Ct. 75, 82 L. Ed. 52 (1937). Speaking here for a unanimous Court, the Justice sustained the validity of the Virginia statute which had twice successfully met the constitutional hurdle in the period before the *Cudahy* decision. *General Railway Signal Corp.* v. *Virginia*, *supra*; *Western Union Gas Construction Co.* v. *Virginia*, *supra*. The Atlantic Refining Co., seeking entrance into Virginia for the first time, objected to paying the maximum fee of $5000 on its authorized capital stock of over $90,000,000. A decision favorable to the statute required explanation in the face of its close similarity to the statute stricken down in the *Cudahy* case. In satisfaction of the principle of stare decisis, Mr. Justice Brandeis fell back upon a distinction between corporation in and corporation out. In each of the earlier cases, "the corporation had, before the exaction held unconstitutional, entered the State with its permission to do local business and pursuant to that permission had acquired property and made other expenditures"; here, nothing like this had occurred to estop the state. *Atlantic Refining* case, *supra*, p. 80. Such a distinction can be rationalized into a tenable position both on strict constitutional grounds and on considerations of broad social policy. After a foreign corporation has with the tacit consent of the state entered into the doing of intrastate business there, the alternative of eviction or submission does smack of unwarranted interference with

the property interests protected by due process. See Note (1938) 51 Harv. L. Rev. 508. Viewed more broadly, the distinction can be thought of as an effective device by which to prevent the extension of judicial protection of the foreign corporation to the newer forms of large scale corporate activity. Such a purpose would seem to be at one with Mr. Justice Brandeis' general concern over increasing corporate power as reflected in his celebrated dissent in *Liggett Co.* v. *Lee*, 288 U.S. 517, 53 Sup. Ct. 481, 77 L. Ed. 929, 85 A.L.R. 699 (1933).

On the other hand, the distinction of corporation in and corporation out can scarcely establish for itself respectable legal parentage. It cannot claim to be the off-spring of the doctrine inaugurated in *Western Union Telegraph Co.* v. *Kansas*, *supra*, and extended in the *Looney* and *Cudahy* cases, *supra*, for in the considerations which dictated this reversal in judicial attitude there is no room for any such distinction. That it cannot claim *Paul* v. *Virginia*, Mr. Justice Holmes pointed out in 1910 when Mr. Justice White first suggested the concept in his concurring opinion in the *Western Union* case, *supra*. Indeed, Mr. Justice Brandeis seems aware of this, for he denies the inherent validity of the distinction even before he gives it life. In an early paragraph of his opinion he declares, "It may be assumed that the rule declared in *Terral* v. *Burke Construction Co.*, 257 U.S. 529, 42 Sup. Ct. 188, 66 L. Ed. 352, 21 A.L.R. 186 (1922) [extending the doctrine of unconstitutional conditions to state denial of suit in the federal courts by foreign corporations] is applicable also to conditions to be performed wholly before admission; and that the $5000 must be refunded if its exaction involved denial of any constitutional right. For we are of opinion that in refusing to grant the authority to carry on local business except upon payment of the $5000 no constitutional right of the company was violated." *Atlantic Refining* case, *supra*, p. 77. Herein lies the fundamental significance of the Court's latest pronouncement, the more significant because the Justice carried the entire Court with him. The distinction between corporation in and corporation out is drawn only in deference to stare decisis; the real purport of the case is that, whether demanded of a corporation in or of one out an exaction measured by total authorized capital stock normally involves violation of neither due process nor the commerce clause.

Taking its cue from majority views expressed in the *Western Union*, *Looney* and *Cudahy* cases, the Refining Company had confidently urged that a statute which measures the charges solely by total authorized capital stock deprives the foreign corporation of due process because the exaction involves the taxation of property beyond the jurisdiction. To

this the Justice answered that the exaction is not a tax upon corporate property but a fee demanded for a privilege granted and arbitrariness cannot be found in a statutory scheme to measure the value of such a privilege by the corporation's total potential economic power as reflected in the amount of its authorized capital stock. Buttressed by the Court's significant action in *Great Atlantic & Pacific Tea Co.* v. *Grosjean*, 301 U.S. 412, 57 Sup. Ct. 772, 81 L. Ed. 1193, 112 A.L.R. 293 (1937), permitting a state to measure its chain store tax upon a chain's total number of units wherever located, Mr. Justice Brandeis clearly leads the Court to an espousal of the view of the supposedly repudiated *Baltic Mining* opinion and of his own dissent in *Cudahy Packing Co.* v. *Hinkle, supra.* By the same token he at a stroke cuts from beneath the *Western Union* decision and its offshoots a significant part of the legal foundation upon which they were rested.

As with the due process point so with interstate commerce, the Refining Co. had built its argument upon the decisions which had seemed to set at rest the question of state power to base a tax upon a foreign corporation's total authorized capital stock. In answer, Mr. Justice Brandeis employs practically verbatim his dissenting argument in the *Cudahy* case. At p. 78 in the *Atlantic Refining* opinion he says: "The entrance fee is obviously not a charge furtively directed against interstate commerce; nor a charge laid upon interstate commerce; nor a charge measured by such commerce. Its amount does not grow or shrink according to the volume of interstate commerce or the amount of the capital used in it. The size of the fee would be exactly the same if the company did no interstate commerce in Virginia or elsewhere. The entrance fee is comparable to the charter, or incorporation, fee of a domestic corporation of a fee commonly measured by the amount of the capital authorized." Gone is the reasoning which supported *Looney* v. *Crane Co.* and *Cudahy Packing Co.* v. *Hinkle, supra;* in its place emerges the view, buttressed by reliance upon the judicial attitude which has always been exhibited toward the domestic corporation, that in fact such a tax imposes no real burden on interstate commerce. Only where interstate and intrastate business are demonstrably interwoven as in the public utility is there any suggestion that the conclusion might be otherwise. The decision in *Atlantic Refining Co.* v. *Virginia, supra,* thus appears to be primarily significant for the basis which it lays for a later repudiation of the restrictions on state power fashioned after 1910, if not of the *Western Union* decision itself.

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